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SOCIAL CONTROL OVER BANKS

IT has been felt for a long time that the banking industry has not been discharging its functions in consonance with the aims of our democratic socialism, viz. 'to regulate our social and economic life so as to attain the optimum growth rate for our economy, and to prevent at the same time any monopolistic trend, concentration of economic power and misdirection of resources."[1] The banking system is a key constituent of our economic life and, therefore, it is necessary that its policies are framed and implemented in a way which helps in achieving the basic social and economic objectives. There should be "an equitable and purposeful distribution" of bank credit amongst the different sectors of the economy. Unfortunately, the banks have been, so far ignoring the credit needs of several priority sectors such as agriculture, small scale industries and export, and the bulk of their advances have been going to large and medium scale industres, big and established business houses. This is clear from the data given in tables I and II.

Table I gives the sector-wise classification of scheduled banks' credit and shows how the bank credit has been growing in Industry as compared with other spheres of its operation.

These figures clearly show how the share of industry in bank credit is constantly increasing at the expense of other sectors of economy. The share of Industry in bank credit rose from 34% in March, 1951 to 64·3% in March, 1966 while those of Commerce and Financial Institutions went down from 36% and 12·7% in March 1951 to 19·4% and 3·6% respectively in March, 1967. The share of agriculture and allied activities remained constant at a low level of 2·1% over this period and here also the major portion of bank credit went to the plantation sector.

Table II shows the contribution of the scheduled banks towards the finances of small scale industries in relation to total credit and

TABLE I

Distribution of Bank Credit to Various Sectors

(in crores of Rs.)

Sector	March 1951		March 1956		April 1961		March 1966		March 1967	
	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total
Industry	198.9	34.0	285.7	37.2	663.8	50.8	1,471.0	62.7	1,748.0	64.3
Commerce	210.6	36.0	281.0	36.5	373.2	28.6	502.3	21.4	526.5	19.4
Financial	74.0	12.7	71.9	9.3	67.1	5.1	77.6	3.3	96.7	3.6
Personal	39.7	6.8	51.1	6.6	87.9	6.7	107.8	4.6	114.5	4.2
Agriculture and Allied Activities (Plantations etc.)	12.4	2.1	15.6	2.0	40.5	3.1	56.5	2.4	56.7	2.1
Others	49.0	8.4	64.9	8.4	73.7	5.6	131.6	5.6	174.9	6.4
TOTAL :	584.6	100.0	770.2	100.0	1,306.2	100.0	2,346.8	100.0	2,717.3	100.0

Source : Reserve Bank of India Bulletin December 1968, p. 1502.

credit to Industry granted by them over the period from December, 1961 to March, 1967.

TABLE II

Scheduled Banks' Advances to Small Scale Industries

(Amount in Crores of Rupees)

Outstanding at the end of	*Advances to Small Scale Industries*	*Advances to All Industries*	*Total Bank Credit*	*Col.* (2) *as % of Col.* (3)	*Col.* (2) *as % of Col.* (4)
1	2	3	4	5	6
Dec. 1961	32·08	640·99†	1,227·20‡	5·0	2·6
Dec. 1962	39·44	893·65*	1,610·70*	4·4	2·4
Dec. 1963	47·72	1,072·53**	1,864·75**	4·4	2·6
March 1965	78·83	1,246·20	2,094·74	5·9	3·5
March 1966	90·76	1,470·90	2,346·80	6·2	3·9
March 1967	178·55	1,747·95	2,717·25	10·2	6·6

†Oct. 1961 * March 1963 ** March 1964

Source : Reserve Bank of India Bulletin, January 69, p. 42.

Thus in December 1961 out of the total credit of Rs. 1227 crores, the share of Small Scale Industry was only 2·6%. This percentage increased by only 4% over a period of six years from Dec. 1961 to March 1967. In relation to credit granted to Industry, the share of the Small-scale Industry was again insignificant. At the end of March, 1967 out of the total credit of Rs. 1,748 crores the share of organised industry was 90% while that of small-scale industry was only 10%. As against this is may be noted that in terms of contribution to national income small-scale industry formed about 6·3% in 1966-67 while the share of organised industry was about 10·1% i.e. only about one and a half times more than that of small-scale industry. The Working Group of the Fourth Five Year Plan also made similar findings in respect of this sector (small-scale industry).

The big and established business houses have also been getting a substantial portion of bank credit partly on account of their position to provide better security, and partly on account of their own men being associated with the board of directors of banks. This fact was also accepted by the Monopolies Enquiry Commission in its report. The Commission observed, "We are bound to mention however that from the facts made available to us by the Reserve Bank of India, it does appear to be true that there have been instances where considerable advances have been made by certain big banks on concessional terms, to concerns in which directors were interested."[2] All this has helped in the growth of concentration of economic power.

These trends leading to lop-sided growth of economy and concentration of economic power are to be checked at the earliest. The credit pattern of the banks needs to be made more broad-based so as to fit in the framework of our planned economy. The Government has examined the various alternatives including nationalisation of banks for achieving the above objectives. Nationalisation has been disfavoured because it would have severely strained the administrative and financial resources of the State besides weakening the structure of our mixed economy. As a matter of fact, "the crux of the problem is to ensure in the immediate future an equitable and purposeful distribution of credit within the resources available." This can be done by evolution of appropriate guidelines for the bank management and to ensure their implementation by streamlining their decision making process so as to make available credit to all such priority sectors which so far have been ignored. Social control over banks has been, therefore, thought to be the right choice in the present context. The objective of social control over banks as envisaged in our country's economy is "to ensure without actual take-over of banks into public ownership the achievements of those social ends that nationalisation could conceivably secure. The major aim clearly is a more purposeful distribution of available credit in terms of accepted investment priorities and correspondingly more efficient mobilisation of savings."[3]

STEPS TOWARDS SOCIAL CONTROL

Let us now examine the important steps taken by the Government so far towards social control of banks and suggest ways and means to make them more effective.

The Banking Laws (Amendment) Act 1968—The Act seeks to extend effective social control over banks. It aims at snapping the link between a few industrial houses and banks so that, "particular clients or groups of clients are not favoured in the matter of distribution of bank credit and whatever the characteristic of shareholding, its influence is neutralised in the constitution of board of directors, and in the actual credit decisions taken at different levels of bank management."[4] The Act prohibits the appointment of any person as director who is connected with a commercial or industrial concern as employee, manager or managing agent and also granting of loans and advances by the banking company to any of its directors or concerns in which any of its directors is interested (sections 10 A and 20). Every banking company is now required to be managed by a whole-time chairman who shall be a professional banker and not an industrialist (section 10B). The Central Government and the Reserve Bank have been given extensive powers under the Act. Section 36 A empowers the Central Government to nationalise any banking company at any time if the interests of the 'banking policy' so require.

It seems that in their over-enthusiasm for social control the framers of the legislation have forgotten the fact that complete prohibition over granting of loans and advances to concerns in which the directors of the banking company are interested may result in denying legitimate banking facilities to most successful entrepreneurs. As a matter of fact the aim should be to formulate positive; meaningful and responsible credit policies so that credit is granted to those who use it in terms of planned economic development and denied to those who will use it otherwise. The granting of immense powes to the Reserve Bank without correspondng liabilities will do more harm than good. The power of the Central Government to nationalise any banking company will really hang as a sword of Damocles over bankers because at any ime, the Government can nationalise banks, if it so decides, by merely an administrative action for satisfying the narrower political interests (which does not seem to be impossible in the context of present political trends in the country) in the name of "banking policy." It would be really beneficial for the country's economy as a whole if suitable changes are made in the Act in the light of these observations.

The National Credit Council—It is a high level body established by the Government to assess periodically the demand for bank credit and indicate the priorities for lending and investment between all sectors of the economy that require credit, in particular the priority sectors such agriculture, small scale industries and export. The membership of the Council is broadly based and includes industrial, trade and banking interests, as well as specialists in agricultural finance, small scale industries, accountancy and economics.

The Council aims at planned allocation of bank credit, the need for which has also been emphasised by Dr. Hazari in his report on "Industrial Planning and Licensing Policy", thus : "Credit planning is one of the main areas which have been left unexplored in the search for instruments to make planning more effective. Planned allocation of credit should henceforth, assume the role of principal strategic control for guidance of investment in both fixed assets and inventories, in place of the diffused variety of direct controls which have been in operation till recently.[5] Thus, the establishment of the Council, though belated is a step in the right direction. The Council does not enjoy a statutory existence. It can serve as a more effective body if the statutory existence is granted to it and is placed as in France, at the apex, of the entire credit and financial mechanism instead of a subsidiary body to the Reserve Bank. However, this disadvantage has been considerably mitigated on account of the Finance Minister being it's Chairman.

The Banking Commission—The Government has appointed a Commission to have a comprehensive expert enquiry into the banking and the monetary structure and the financial needs, policies and practices. of our banking system. The terms of reference of the Commission have already been announced and it is hoped that with the wide terms of reference and the expert knowledge, the Commission would be able to suggest ways and means to place the Indian Banking on sound footing.

Though the terms of reference of the Commission are quite wide but two important aspects have been left out of its purview. They are (*i*) a study of the structure of existing interest rates, and (*ii*) a scrutiny of the credit control measures. There is an urgent necessity for an orderly structure of interest rates covering the economy as a whole and not only the organised banking sector. Money market rates are more or less linked with the bank rate but thes ame does not apply to the interest offered by the Government on its small savings schemes and post office savings banks' accounts. It will be better if the Government can direct the Commission to make recommendations on the minimum margin as between ceilings on deposit rates and floor for lending. rates in order to ensure an adequacy of bank profitability. The Commission should also scrutinize the causes of the failure of the existinrg credit-control measures and suggest ways and means to refashion them or evolve new ones so as to fit in our present day requirements and thus help in proper functioning of the banking and the finanial mechanism.

MAKING SOCIAL CONTROL MORE EFFECTIVE

Although governmental measures have been taken to initiate the scheme of social control over banks, a more concerted action is called for. This visualises more of volitional endeavours and discipline by the banking industry as a whole. The more crucial areas for such action include :

(1) *Deposit Mobilisation*—Commercial banks should now launch an effective scheme of deposit mobilisation particularly in the rural areas so that they may be in a position to meet the additional demands of bank credit by agriculture and also at the same time fulfil their commitments to the industry. It is estimated that rural sector savings income ratio has gone up from 2% in 1950-51 to 20% in 1967-68. Commercial banks have at present about 7000 offices which are apparently insufficient to make a successful thrust in the rural field. At its third meeting held on March 21, 1969 the National Credit Council agreed with the basic point made by the study group on deposit mobilisation that it is necessary to speed up the process of opening branches in semi-urban and rural areas. The Council in this context has suggested that the bank should adopt a positive target that every town as defined in the Census Report which has a population of more than 10,000 should be covered by the end of 1970.

The suggestion of the Council is to be welcomed in the context that undoubtedly India lives in villages and it has been estimated that out of 5,70,000 villages modern banking facilities are available in hardly 5000 villages. This wide gap underlines the paramount need of spreading the benefits of banking to the rural population. But the process of opening new branches cannot be carried on and sustained for long merely on ideological ground of necessity for extending branch net work to all rural or semi-urban areas. Banks will have to see the deposit yielding potential of the areas where they open branches and have to relate the current and future earning capacity and deposit potential of such branches to the costs of maintaining them as part of their branch net work. Rural branches cannot function as viable units if they are maintained on the same pattern of administration and wages on which the urban branches are maintained. Moreover, their maintenance on urban pattern will result in social tension that is likely to arise out of wide disparity in the earnings of different strata of the rural community. It will be, therefore, appropriate to exempt the rural branches from the purview of the Industial Disputes Act, Labour Awards and Shops and Establishment Acts. A revised wage structure for staff serving in the rural branches should be evolved in consultation with the employees' unions. Costs of providing modern banking facilities in rural areas may further be reduced if District or Rural Banks are sponsored by four or five banks on a consortium basis. The share capital of such a bank will be subscribed by the sponsoring banks. A sponsored bank being small in size and having a limited area of operations will be in a better position to utilise its local connections for mobilising substantial deposits. It will also inspire public confidence on account of support and assistance of all India banks.

Tax Exemptions—Though the major responsibility for mobilisation of deposits rests on the banking industry itself, the Government can also lend a helping hand by suitable tax concessions in the following two directions—

(*a*) The interest income to the extent of Rs. 1,000/- should be exempted from tax in the hands of the depositors. At present this type of tax concession is available on dividends received from Indian Companies. Such a step will definitely encourage savings on a wider and larger scale.

(*b*) The banking companies should be granted exemption from tax on appropriation to reserves to the extent of 1/10 of their profits. At present this type of exemption is available only to financial corporations engaged in providing long-term finance for industrial development. This step will strengthen the reserves of the commercial banks which at present is necessary to meet new risks and possible losses arising due to opening of new branches in the rural areas. This will enlarge the cushion to banks and thus embolden them to extend their operations in relatively new areas.

(2) *Security Considerations*—One of the main difficulties in lending to the farmers and small entrepreneurs is the absence or inade-

quacy of security. Canons of sound banking viz safety, liquidity and profitability cannot be overlooked by a banker whether his customer is a farmer, an industrialist or a tradesman. The Debts Relief Acts, The Tenancy Acts etc., enacted in diffierent states solely for the purpose of protecting the interests of the farming community have reduced the farmer to a second class borrower. A banker cannot afford to ignore these legislations and, therefore sooner the State Governments remove this disqualification, the better. Besides this to encourage commercial banks to participate increasingly in providing long term finance to agriculture it is necessary to guarantee the repayment of such loans by a specialised institution formed for this purpose on the pattern of the Farming Loans Guarantee Corporation Ltd. in U.K. or Deposit Insurance Corporation or Export Credit Guarantee Corporation in our country. For the present the work may be taken up by the Agricultural Refinance Corporation or by the State Governments or Gram Panchayats. The experience of Gram Panchayats standing as sureties for loans granted by banks to agriculture and small scale industries has proved to be very useful in Guntur district of Andhra Pradesh.

In Western Countries Crop and Cattle Insurance Schemes are also very popular. These schemes, if introduced in our country, will greatly minimise the risk in farm finance and induce banks to provide more and more finance to the vital but so far utterly neglected agricultural sector.

It will be useful to point out here the observations made at a recent seminar, held in New Delhi, on credit facilities to small scale industries. It was observed that the small units are good credit risks and the commercial banks should, therefore, shift emphasis from security to promotion taking into consideration the credit-worthiness of the entrepreneur rather than the actual coverage available for the credit given to small-scale units. It was further emphasized that the small-scale entrepreneurs were "basically honest, enterprising and with far greater personal stake in their enterprises than the large scale entrepreneurs."[6]

(3) *Co-ordination between Commercial and Co-operative Banks*—The entry of the commercial banks in rural finance has not been much liked by a powerful section of the credit co-operatives on account of the fear that commercial banks with their systematic way of doing

business might offer a formidable competitition to them. This fear is unfounded because the credit requirements of the agricultural sector alone are estimated between 2000 to 2200 crores of rupees and the co-operative banks with their present resources can meet only one third of these credit requirements and thus leave sufficient business for the commercial banks. If necessary, the co-operative and the commercial banks can agree for their respective spheres of operation. Co-operative credit agencies may provide production finance and leave the other lines, such as marketing, processing, industrial and commercial co-operatives, for the commercial banks to look after. A lot of wasteful competitition resulting from a duplication of banking organisation in the same area can be avoided by "the area development approach." Under this scheme each bank inc'uding co-operative banks is allotted a certain number of districts or areas, depending on its location and resources, for intensive development. Each bank is expected to concentrate all its efforts on opening branches, providing agricultural finance, financing small scale industries and mobilising deposits in the selected districts or areas only. It formulates five, seven or ten years development plans for the selected areas and the results are judged over the period of the plans so that limited resources are not wasted away in needless competition.

(4) *Indirect Finance*—It is better if the commercial banks go slowly in the field of direct production finance to farmers on account of the enormity and complexity of the problem of rural credit. As a matter of fact long before in 1957 an *ad hoc* committee appointed by the Reserve Bank to go into the entire problem of rural credit came to the conclusion that the State Bank should not finance farmers directly but only through marketing and processing co-operatives, precisely on account of the same reasons. Commercial banks can provide indirect finance to agriculture and small scale industries by subscribing to the debentures of Land Mortgage Banks and State Electricity Boards. Both these investments will not only give a higher rate of return to the banks but will also enable them to contribute towards the long term financial requirements of agriculture.

The scheme of social control if properly implemented with the suggestions given above will lead to a positive reorganisation of the banking system on sound lines and will enable it to function as "an effective vehicle for the implementation of monetary and credit policy of the Reserve Bank." Though it is too early to assess the success of this scheme but there is enough evidence to show that the banking system has attuned itself to the new environment. As a matter of fact the banks accepted the scheme of social control even before the final enactment of the banking legislation. The Chairmen of all major banks have resigned to make way for Chief Executives and their board of directors have also been reconstituted in accordance with the recent amendments in the Act. The beginning is good but the success of the scheme finally depends upon banks' capacity to imbibe a new spirit and sense of involvement and commitment in all those connected with the banking, irrespective of the positions they occupy, about the task of fulfilling the laudable objectives of social control.

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[5] Hazari, R.K., *Report on Industrial Planning and Licensing Policy*, p. 26.

[6] Commerce, March 1, 1969, p. 360